

IDT Corp. v Morgan Stanley Dean Witter & Co.
2008 NY Slip Op 31001(U)
April 4, 2008
Supreme Court, New York County
Docket Number: 0603710/2004
Judge: Herman Cahn
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. Herman Cahn PART 49

Justice

IDT CORPORATION

603710-04

INDEX NO. 603752706

MOTION DATE _____

- v -

MOTION SEQ. NO. 6

MORGAN STANLEY DEAN WITTER

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

PAPERS NUMBERED

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits _____

Replying Affidavits _____

Cross-Motion: Yes No

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE in 007

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE DATED: _____

J.S.C.

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Dated: April 4 2008

Herman Cahn

J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 49

-----X

IDT CORPORATION,
Plaintiff,

-against-

Index No. 603710/04

MORGAN STANLEY DEAN WITTER & CO. and
MORGAN STANLEY & CO., INC.,

Defendants.

-----X

Herman Cahn, J.:

Motion Sequence numbers 006 and 007 are consolidated for disposition.

Defendants move to dismiss the sixth and seventh causes of action in the amended complaint for failure to state a cause of action. Defendants also move to stay discovery relating to these same causes of action pending decision on the motion to dismiss.

This is a dispute between a client, IDT Corporation, and its former investment banker, Morgan Stanley Dean Witter & Co. and Morgan Stanley & Co., Inc. (together Morgan Stanley), in which IDT claims that Morgan Stanley induced another of its clients, Telefonica Internacional, S.A. (Telefonica) to breach a contract with IDT. It is alleged that Morgan Stanley misused and misrepresented the conclusions to be drawn from IDT's confidential financial and business information. Allegedly, Morgan Stanley engaged in this conduct in order to encourage Telefonica to contract with other clients of Morgan Stanley, thus enabling Morgan Stanley to earn millions of dollars in additional fees.

At issue in this motion, are claims for fraudulent misrepresentation and fraudulent concealment. In these claims, IDT alleges that in response to a subpoena issued in an arbitration

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proceeding between IDT and Telefonica, Morgan Stanley failed to produce key documents in its possession, and affirmatively represented that such evidence did not exist. In connection with the within action, the documents were eventually produced. IDT claims that had the documents been produced in response to the subpoena in the arbitration proceeding, it would have obtained a much larger and more favorable recovery in the arbitration proceeding. Morgan Stanley contends that discovery abuse is not the basis for an independent tort claim, and that IDT cannot demonstrate that it suffered any damages as a result of the earlier failure to produce documents.

BACKGROUND

At all relevant times, Morgan Stanley served as investment banker to IDT (Am Compl, ¶ 8). On August 11, 1999, IDT entered into a memorandum of understanding (MOU) with Telefonica with respect to Telefonica's planned Latin American submarine cable network, known as Sam-1, a fiber optic cable circling Latin America (Am Compl, ¶¶ 23-24). IDT alleges that in late 1999, Morgan Stanley, despite its relationship of trust and confidence with IDT, provided IDT's confidential and proprietary business information to Telefonica and advised it to decrease or eliminate IDT's interest in the Sam-1 network (Am Compl, ¶ 30). It also began to actively promote the participation of other anchor tenants in the Sam-1 network (*id.*, ¶¶ 31-33). IDT alleges that the ultimate goal was to replace it as anchor tenant and, in doing so, earn substantial investment banking fees from other parties (*id.*, ¶ 33).

Ultimately, Telefonica delayed and then terminated the MOU, in breach of that agreement. IDT commenced an arbitration proceeding against Telefonica in accordance with the MOU. IDT alleges that it only learned of Morgan Stanley's conduct when document discovery took place between December 2001 and March 2002 in connection with the arbitration. In

December 2001, IDT served Morgan Stanley with a subpoena seeking documents. In response to the subpoena, Morgan Stanley produced over 2,000 pages of documents, and asserted that it could not find any more documents responsive to the subpoena (Hess Opp Aff, Exh 9). These documents disclosed the conduct that Morgan Stanley had up to that point been concealing (Am Compl, ¶ 48). The arbitrators found in favor of IDT, determining that Telefonica had breached the MOU (id., ¶ 46). IDT was awarded damages.

On November 4, 2004, IDT commenced this action, alleging claims for breach of fiduciary duty, intentional interference with contract, intentional interference with prospective business relations, misappropriation of confidential and proprietary business information, and unjust enrichment. On defendants' prior CPLR 3211 motion to dismiss, the claim for intentional interference with prospective business relations was dismissed by the Court (Hess Opp Aff, Exh 1). That determination has been upheld by the Appellate Division, First Department (IDT Corp. v Morgan Stanley Dean Witter & Co., 45 AD3d 419 [1st Dept 2007]).

IDT sought documents from Morgan Stanley, and served a subpoena similar to the one served in the arbitration. After a court-ordered search of Morgan Stanley's files, in October 2006, two previously unproduced documents were produced. IDT contends that these documents show that Morgan Stanley induced Telefonica to breach its contract with IDT, and show when the breach occurred. The first document is an October 4, 1999 letter written by two Morgan Stanley officers to the Chairman of Telefonica, which states in part that "Morgan Stanley advises Telefonica against selling equity in the Sam-1 project at cost, and would encourage Telefonica to reevaluate its agreements with IDT and Tyco" (Hess Opp Aff, Exh 11). The second document is an outline, dated October 1, 1999, entitled "Project SAM Issues and Workslope for 1 October

1990” (id. at Exh 13). In it, according to IDT, Morgan Stanley suggests new partners for the Sam-1 project, even citing concerns about the reaction of Telefonica’s lawyers (id.). These documents were responsive to the December 2001 subpoena, but had not been produced in the arbitration or to the arbitrators.

IDT then moved for, and was granted leave to, amend its complaint to add two causes of action – one for fraudulent misrepresentation, and the other for fraudulent concealment (id. at Exh 5). These are the claims at issue on this motion. In the sixth cause of action, IDT alleges that Morgan Stanley materially misrepresented its compliance with the December 5, 2001 subpoena, and its compliance with the arbitration process. IDT alleges that Morgan Stanley excluded critical documents in existence and in its possession at the time (Am Compl, ¶ 84). It alleges that Morgan Stanley made representations of compliance with the subpoenas in order to defraud IDT, and undermine its ability to arbitrate and to litigate this action (id., ¶ 85). It asserts that it reasonably relied on Morgan Stanley’s representations during and after the arbitration, that it had produced all responsive documents, and that it was damaged by Morgan Stanley’s misrepresentations and non-compliance (id., ¶¶ 86-87). IDT seeks punitive damages based on Morgan Stanley’s gross misconduct (id., ¶ 88).

In the seventh cause of action, IDT alleges that Morgan Stanley had a duty to disclose the documents in order to comply with the subpoena and that Morgan Stanley had a fiduciary duty to IDT as its investment banker, which duty it breached by failing to disclose the responsive materials (id., ¶¶ 90-95). IDT alleges that it suffered damages, and that Morgan Stanley should be assessed punitive damages for abuse of the discovery process, for withholding information in response to a valid subpoena, for presenting false and misleading evidence to the arbitration

panel and for its gross misconduct (id., ¶¶ 96-97).

Morgan Stanley now moves to dismiss these two causes of action for failure to state a cause of action. It asserts that these claims seek to elevate a claim about the arbitration discovery process into an independent tort. It argues that New York does not recognize spoliation of evidence as a cognizable tort cause of action. Morgan Stanley further argues that IDT has failed to allege and cannot establish that it suffered ascertainable damage as a result of the failure to produce documents.

In opposition, IDT contends that it is not alleging spoliation; rather, it is alleging that Morgan Stanley fraudulently misrepresented and fraudulently concealed documents that existed, and which it refused to produce. It urges that Morgan Stanley materially misrepresented its compliance with the December 2001 subpoena, and that its misrepresentations and concealment were made intentionally in order to defraud IDT and to undermine its ability to prosecute its arbitration claims. It contends that it reasonably relied on Morgan Stanley's representations that it had produced all responsive documents. It contends that it suffered damages in that, in the arbitration, there was no dated document between officers of Morgan Stanley and the Chairman of Telefonica with express advice to Telefonica to "reevaluate its agreements with IDT and Tyco" (Hess Opp Aff, Exh 11). It asserts that the precise date of breach clearly affected the damage award, particularly in light of the decline in the telecommunications market (see Arbitration Decision at 31, 36, 45-51). It contends that the arbitrators determined that the breach occurred somewhere between October 2000 and March 2001, but that these documents indicate that Morgan Stanley's interference as well as Telefonica's breach occurred much earlier, possibly as early as October 1999. Thus, it asserts that it has clearly suffered damages. As far as the

amount of damages, IDT argues that it is entitled to seek the value of what it gave up and what it received, the lost value from the different breach dates of its contract, by Morgan Stanley's fraud and fraudulent concealment.

DISCUSSION

The motion to dismiss is granted and the sixth and seventh causes of action of the Amended Complaint are dismissed. The motion to stay discovery is denied.

On a CPLR 3211 motion to dismiss, the test is whether the proponent of the pleading has a claim, not whether a claim is stated (see Leon v Martinez, 84 NY2d 83, 87-88 [1994]). The plaintiff's factual allegations must be accepted as true, liberally construed and afforded the benefit of every favorable inference (id.). Notwithstanding this, the causes of action must be dismissed.

The gravamen of both the sixth and seventh causes of action are Morgan Stanley's claimed concealment of documents in its possession in the arbitration discovery process IDT was conducting with Telefonica. Essentially, these claims seek recovery in tort against an entity that was not a party to the proceeding, in this case an arbitration, for an abuse of discovery. Recently, the Court of Appeals, held in Ortega v City of New York that an independent tort claim for spoliation of evidence against a third party, whether negligent or intentional, is not cognizable (Ortega v City of New York, 9 NY3d at 83; MetLife Auto & Home v Joe Basil Chevrolet, Inc., 1 NY3d 478, 483-84 [2004] [no claim for spoliation of evidence against a nonparty to the underlying claim]; see also Seaport Park Condominium, Inc. v Greater N.Y. Mut. Ins. Co., 2007 WL 4221650, at *13-14 [Sup Ct, NY County Nov 19, 2007] [Tolub, J.] [no independent tort claim for third party negligent spoliation]; Tiano v Jacobs, 2001 WL 225037, at *4 [SDNY

March 6, 2001] [Chin, J.] [while there are many ways under New York law for a court to sanction a party who conceals or destroys evidence, there is no separate legally cognizable tort claim for spoliation]).

In Ortega, the plaintiffs had been injured when the minivan in which they were traveling burst into flames, causing them to suffer severe burns (9 NY3d at 73). The van was impounded by the police, and the plaintiffs obtained a court order granting them a period of 60 days to inspect it (id.). The order precluded alteration or destruction of the van until completion of the inspection (id.). The plaintiffs did not receive notice from the City Pound regarding the disposition of unclaimed vehicles, and the Pound crushed the remains of the van for scrap metal following its ordinary procedures. The plaintiffs asserted claims against the City of New York, seeking compensation for the personal injuries they sustained as a result of the van fire (id. at 74). They argued that the City was liable because it breached a duty to preserve the evidence, and committed the tort of negligent spoliation of evidence. They also claimed that the City committed civil contempt by violating the preservation order (id.).

The Ortega Court recognized that the plaintiffs in that case had demonstrated an interference with an interest that was worthy of protection, but determined that that was only the beginning of the analysis (id. at 78). It emphasized that “[w]hile it may seem that there should be a remedy for every wrong, this is an ideal limited perforce by the realities of this world”(id., [quoting Trombetta v Conkling, 82 NY2d 549, 554 [1993]]). It weighed various judicial and social policy concerns, including that there are existing remedies adequate to deter spoliation, and that the claims would rely upon “hypothetical theories or speculative assumptions about the nature of the harm incurred or the extent of plaintiff’s damages,” (id. at 79-81), and declined to

recognize spoliation of evidence as an independent tort claim (id. at 83). It pointed out that to establish causation and damages, a party pursuing a spoliation claim would have to show that a jury in the underlying litigation would have found differently if the original and unaltered evidence had been before it. The Court found that it would involve the utmost in speculation for a jury to decide what persuasive effect the item would have had on the jury in the underlying action (id. at 81). It also found that, in many cases, discovery sanctions, for example under CPLR 3126, would be adequate to deter spoliation or to compensate its victims (see id. at 79; see also MetLife Auto & Home v Joe Basil Chevrolet, Inc., 1 NY3d at 483-84 [one method of dealing with spoliation has been sanctions under CPLR 3126, including dismissal]; Tiano v Jacobs, 2001 W6 225037 at *4 [there are many ways under New York law for a court to sanction a party who conceals or destroys evidence]). Further, the Ortega Court reasoned that even in cases where a third party, with a duty to preserve the evidence but who is not connected to the underlying action or proceeding, breaches that duty, the plaintiff is not left without recourse – the civil contempt statutory scheme permits the party who suffers a loss to seek full compensation from the violator (Ortega, 9 NY3d at 80). Thus, the Court of Appeals declined to recognize an independent tort claim for spoliation of evidence (id. at 83).

This Court is constrained to follow Ortega v City of New York, and find that these causes of action for fraud and fraudulent concealment are essentially third party spoliation claims. Spoliation has been defined as “the intentional destruction, mutilation, alteration, or concealment of evidence, [usually] a document” (MetLife Auto & Home v Joe Basil Chevrolet, Inc., 303 AD2d 30, 33-34 [4th Dept 2002], affd 1 NY3d 478 [2004] [quoting Black’s Law Dictionary 1409 [7th ed 1999]]). Here, IDT’s claims revolve around Morgan Stanley’s concealment of documents

responsive to a subpoena served in the underlying arbitration. These allegations fall within that definition of spoliation (id.). Contrary to IDT's argument, spoliation is not just alteration and destruction of evidence. The definition includes concealment. The fact that IDT has framed the claim that Morgan Stanley's concealment of and failure to produce documents as a fraudulent misrepresentation does not take it out of the rules regarding spoliation of evidence claims. Otherwise, a party could easily circumvent the rule against independent spoliation claims by simply asserting fraud or fraudulent concealment. The claims relate to an abuse of discovery, the concealment or withholding of evidence, which occurred in a previous proceeding, and are barred (see Ortega, 9 NY3d at 83; see also Temple Cmty. Hosp. v Superior Court, 20 Cal 4th 464, 472-73, 976 P2d 223, 226-229 [Cal 1999] [no tort claim for concealment or withholding evidence]).

As in the Ortega case, Morgan Stanley had a duty to produce the documents, pursuant to the subpoena, and apparently breached that duty. This Court clearly does not condone such conduct. Nevertheless, IDT may not seek redress through an independent tort claim for breach of that duty. It is possible that the evidence of Morgan Stanley's claimed concealment may be admitted at trial under the claims IDT already has against it. However, that issue will necessarily await the trial.

Moreover, the same concerns the Ortega Court had about speculation are evident in this case, although to a much lesser degree. IDT contends that the letter and outline would have demonstrated that the breach occurred in October 1999, and not later. It is clearly possible that the arbitrators would have had differing views on this evidence, its weight and significance with regard to the date of breach, and on the nature of the harm incurred and IDT's damages. There is

no meaningful way, with regard to these two causes of action, for a trier of the facts to reliably resolve whether the documents would have affected the arbitrators' determination regarding the date of the breach. It is not clear what precisely the documents would have shown, beyond what was already shown in the documents that were produced and relied upon in the arbitration, and how much they would have weighed in IDT's favor. It would be a matter of speculation about the extent to which the concealment of the two documents caused a different result in the arbitration, particularly given the discretion vested in the arbitrators (see Ortega, 9 NY3d at 81). Further, recognition of an independent tort claim could result in potentially endless litigation, requiring relitigation of the arbitration in order to permit IDT to demonstrate in what respect the concealment altered the outcome of the first proceeding. While this Court is sympathetic to the claim, the recognition of interference with an interest worthy of protection is only the beginning of the analysis (see id. at 78). As the Ortega Court reaffirmed, the realities of this world impose a limit on the ideal of providing a remedy for every wrong (id.; Trombetta v Conklin, 82 NY2d at 554).

IDT's reliance upon P.T. Bank Central Asia v ABN AMRO Bank N.V. (301 AD2d 373 [1st Dept 2003]) is misplaced. In that case, the plaintiff alleged that the defendant bank, while it was soliciting plaintiff to participate in a loan, fraudulently misrepresented the value of the collateral supporting the loan, and fraudulently failed to disclose information calling into question the appraised value of that collateral (id. at 375). This is factually distinguishable from the instant case in that it involves a common fraud scenario with a defendant trying to lure a plaintiff into a course of action, by withholding or misrepresenting material information. Here, IDT is not alleging that Morgan Stanley was concealing material matters to entice IDT into a

transaction or a course of action. Rather, it alleges that Morgan Stanley violated a subpoena by not turning over documents sought in an arbitration to which it was not a party. It seeks damages for Morgan Stanley's abuse of the discovery process, and is clearly more analogous to the Ortega case, which requires dismissal of these causes of action. Therefore, the allegations in the sixth and seventh causes of action in the Amended Complaint fail to state a claim for relief, and are dismissed.

The motion for a stay of discovery pending the determination of this motion is denied as moot.

Accordingly, it is

ORDERED that the motion to dismiss is granted and the sixth and seventh causes of action in the Amended Complaint are dismissed; and it is further

ORDERED that the defendants are directed to serve an answer to the Amended Complaint within 10 days after service of this order with notice of entry; and it is further

ORDERED that the motion to stay discovery is denied.

Dated: April 4, 2008

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